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September 16, 2008

## **AGENDA ITEM #5**

### **TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE**

**I. SUBJECT:** Proposed Regulations: Determination of "Employee" Status

**II. PROGRAM:** Retirement

**III. RECOMMENDATION:** Staff recommends that the Committee recommend that the Board approve for publication the proposed regulations which make specific the criteria to determine whether an individual is the employee of a CalPERS-covered employer.

#### **IV. ANALYSIS:**

The proposed regulations make specific the criteria to be used when determining whether an individual qualifies as an employee for CalPERS' purposes. The proposed regulations were prepared to assist employers and CalPERS' staff in determining whether an individual is an employee of a CalPERS-covered agency, who may be eligible for CalPERS' membership.

Only individuals who are employees of a CalPERS-covered agency are eligible for CalPERS' membership. The determination of employee status is crucial because in order to preserve the tax-qualified status of the system, CalPERS must ensure it provides retirement benefits only to the common law employees of the state, school employers and contracting agencies. Under Internal Revenue Code section 401(a), a requirement for pension plan qualification (and exemption from federal taxation) is that the plan of an employer must be for the "exclusive benefit" of the employer's employees and their beneficiaries.

Government Code section 20125 states that the Board shall determine who are employees and is the sole judge of the conditions under which persons may be admitted to and continue to receive benefits under this system. Section 20028 generally defines an "employee" as "any person in the employ of" the state, a school employer or a contracting agency. Since this is a very general definition, CalPERS looks to common law requirements to determine employee status.

In 2004, the California Supreme Court confirmed that the California common law control test was the test to be used to determine if individuals were employees of the Metropolitan Water District (MWD) for the purposes of CalPERS' eligibility. (*Metropolitan Water District of Southern California v. Superior Court of Los Angeles*, (2004) 32 Cal.4<sup>th</sup> 491 often referred to as the "Cargill" case.) In that case, the MWD hired persons through a temporary employment agency and considered such persons to be "employees" of the temporary employment agency and not employees of MWD for CalPERS' purposes.

After the *Cargill* decision, the CalPERS Board of Administration adopted as precedential its decision entitled *In the Matter of the Application for CalPERS Membership Credit by Lee Neidengard v. Tri-Counties Association for the Developmentally Disabled*, (Case No. 05-01), a case which determined whether Lee Neidengard served as an employee or independent contractor when performing service for Tri-Counties Association. In this precedential decision, the Board cited the case of *Tieberg v. Unemployment Ins. App. Bd.*, (1970) 2 Cal.3d 943, which articulated the California common law factors for making such a determination and explained, citing to the *Tieberg* case, "In determining whether one who performs services for another as an employee or an independent contractor, the most important factor is the right to control the manner and means of accomplishing the result desired." Citing to *Cargill*, the Board also concluded in *Neidengard* that since the PERL does not define "independent contractor" or "employee" of a contracting agency with greater particularity, these terms must be defined with reference to California common law.

The proposed regulation incorporates into Chapter 2 of Division 1 of Title 2 of the California Code of Regulations the factors referred to in the *Cargill* and *Neidengard* decisions that make specific the criteria used to determine employee status.

The adoption of these clarifying regulations will benefit the public, CalPERS' employers and members, and CalPERS' staff by reducing uncertainty and decreasing the numbers of appeals and litigation over the question of who is an employee. The proposed new regulations are in Attachment I for the Committee's approval.

If Board approval to proceed with the regulations is received, the following rulemaking amendment process is planned:

- Publication of the Notice of Proposed Regulatory Action package in the California Regulatory Notice Register;
- A minimum 45 day written public comment period;
- A public hearing scheduled for a future BPAC meeting;
- Final Board approval;

- Transmission to OAL for filing with the Secretary of State and publication in the California Code of Regulations.

The regulations will become effective 30 days after filing with the Secretary of State. If no changes are made to the regulations during the comment period, they could take effect in early 2009. This schedule could be lengthened if substantive changes pursuant to public comment and additional comment periods are necessary.

**V. STRATEGIC PLAN:**

Implementation of these regulations is not a specific product of the Strategic or Annual plans but is part of the regular and ongoing workload of the Employer Services Division.

**VI. RESULTS/COSTS:**

Implementation of these regulations will help CalPERS to comply with Federal tax laws, maintain a consistent practice of enrolling members at the appropriate time, and also ensure that the actuarial liabilities of such membership are accurately computed.

CalPERS may achieve cost savings as a result of decreased litigation and administrative appeals dealing with these issues, as employers and individuals become more aware of the criteria CalPERS uses in making such determinations.

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Employer Services Division

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Ronald L. Seeling, Chief Actuary  
Actuarial and Employer Services

Attachment